

# Virginia Department of Social Services

## TITLE IV-E MATRIX UNDERSTANDING AND CLAIMING IV-E FOSTER CARE ADMINISTRATIVE COSTS March 1, 2004

### ➤ **Examples of Cost Allocation Methods:**

Three proven examples of cost allocation methodologies for allocating shared (pooled) costs which are not able to be directly charged, and are allocated as a pool of costs are:

- 1. Units of Service**
- 2. Cost-to-Cost**
- 3. Functional**

For shared administration costs, they must be those benefiting all the corporation's program areas. Therefore, if there are some administration costs that benefit only a portion of the corporation's program areas, then an allocation method must be used to properly allocate that subset of administration costs to those program areas benefiting from those administration costs. For example, if you have a subset of administration costs only benefiting your residential child care programs, you could allocate that subset based upon units of service. Then, when allocating on a cost-to-cost basis those shared administrative costs benefiting all your program areas, the cost basis for each of your residential child care programs would include the program's direct care costs and its allocated share of the subset of administrative costs.

### **1. Cost Allocation Method: Units of Service Method**

In order to use the units-of-service cost allocation method, each of the program areas would have to deliver the same type of services [i.e., equivalent services (i.e., residential)] and would have to be measured with the same units of service [i.e., equivalent units (i.e., 24 hours)].

If all program areas do not have equivalent units of equivalent services, the cost-to-cost allocation method must be used for shared (pooled) administration costs that are not directly chargeable to a specific program area. A functional method could be used for those costs which would be more accurately allocated using this method.

For example, indirect administration costs must be allocated between all of the programs which the contractor or its controlling entity operates. If one location has several 24-Hours Child Care Programs that share common facilities and are used by the programs, then the costs for these facilities may be allocated between programs on an equitable basis.

If a contractor administers three 24-Hour Residential Child Care facilities and has no other programs, then equivalent units of service can be used as the allocation method. This is because they all operate on a 24 hour per day basis. If a contractor has four programs, however, three which operate on a 24 hour per day basis and one which operates on an 8 hour per day basis, then the equivalent units of service method could not be used to allocate costs between the four programs. A cost-to-cost method of allocation is required to allocate the costs between the facilities. In this case, a cost-to-cost allocation method could be used to allocate the indirect costs between the program operating on an 8 hour per day basis and the three programs operating on a 24 hour per day basis. Costs between the three 24 hour per day programs could then be allocated between programs using equivalents units of service since each of the three programs operates on a 24 hour per day basis.

If the Units of Service method can not be used, the Department recommends that you begin with the development of a cost-to-cost allocation method. If there is administration costs that might be better allocated through a functional allocation, develop a functional allocation method for each of those administration costs.

An example of providing a clear and understandable explanation of the numerator and denominator of the allocation ratios described in words and in numbers is shown below:

Allocation of \$100,000 of indirect administration costs was required. To develop the allocation ratios, the Days of Service (DOS) were determined for each of our three programs. The total DOS were 10,000. The allocation ratios were determined by dividing the DOS for each Facility or Program by the total DOS. The results were as shown in the following table:

Facility # or Program	DOS	Percentage of Total DOS	Allocated Shared Administration Cost
X0X0X0	2500	25%	\$25,000
000000	4500	45%	\$45,000
AAAAAA	3000	30%	\$30,000
Total	10000	100%	\$100,000

## **2. Cost Allocation Method: Cost-to-Cost Method**

The cost-to-cost allocation method must be representative of the actual operations of the corporation. Cost-to-cost allocation methods calculate a program's percentage of a specified cost basis and use that percentage to then calculate that program's share of administration costs.

Administration costs are always allocated first to each program area, then any unallowable administration costs are removed from each program area for purposes of contracting with the Department. In this manner, it is ensured that 100% (and only 100%) of the total administration costs have been allocated across the various program areas.

The specific cost bases can include any one of the following:

- Salaries;
- Salaries, payroll taxes and employee benefits;
- Salaries and contract labor;
- Salaries, payroll taxes, employee benefits, and contract labor; and
- All direct program costs minus building costs, if any.

When selecting one of the specific cost bases above, you must analyze the cost to ensure there is not a big disparity between the costs. For example, if you have three programs that share administrative costs and the cost-to-cost allocations based on salaries is selected and two programs have approximately \$30,000 in salaries and the third \$5,000 in salaries, then you should move to the next tier (salaries, payroll taxes and employee benefits).

An example of providing a clear and understandable explanation of the numerator and denominator of the allocation ratios described in words and in numbers is shown below:

Allocation of \$100,000 of indirect administration costs was required. To develop the allocation ratios, Direct Program Salaries were chosen as the specific cost basis. The Direct Program Salaries were determined for each of our three programs. The total Direct Program Salaries were \$1,000,000. The allocation ratios were determined by dividing the Direct Program Salaries for each Facility or Program by the total Direct Program Salaries. The results were as shown in the following table:

Facility # or Program	Salaries	Percentage of Salaries	Allocated Shared Administration Cost
X0X0X0	\$250,000	25%	\$25,000
000000	\$450,000	45%	\$45,000
AAAAAA	\$300,000	30%	\$30,000
Total	\$1,000,000	100%	\$100,000

### **3. Cost Allocation Method: Functional Method**

Costs may be more accurate and representative based upon a functional methodology rather than a cost-to-cost allocation method. The functional method is a direct method of reporting shared costs.

The following are examples of functional allocation bases:

- Costs of a central payroll operation could be allocated to all business components based on the number of checks issued;
- Costs of a central purchasing function could be allocated based on the dollar amount of purchases made or requisitions handled;
- Payroll costs for a direct care employee working across business components should be allocated based upon that employee's actual timesheets;
- Payroll costs for an indirect employee working across business components could be allocated based upon a documented time study;
- Food costs could be allocated based upon the number of meals served;
- Transportation equipment costs could be allocated based upon mileage logs.
- Building costs shared by more than one program must be allocated using square footage.

For example, if the building used for 24-Hour Residential Child Care is not solely used for this program, the allocation of such shared building costs should be based on square footage (for utilities, building insurance, building repairs and maintenance, janitorial services, pest control services, security services, mortgage interest, ad valorem taxes, and/or building depreciation).